THE ECONOMIC AND POLITICAL CLIMATE FOR FARMING

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The events of the last couple years may be likened to an economic tale of "best of times" and "worst of times." Grain farmers thoroughly enjoyed rising grain prices and the big bulge in net farm income beginning in 1972. But livestock farmers were increasingly squeezed by rising feed costs and low or negative margins. The food processing-input industries consider the last two or three years as one of the "best of times" but consumers with food prices escalating faster than disposable income consider these years "a bad scene " Landowners have benefited from the "best of times" to such an extent that inheritance taxes have emerged as a big problem. Common stock owners have been disillusioned by declining dividends and values and most can't remember comparable "worst of times."

GENERAL EXPECTATIONS INFLUENCING AGRICULTURE

Every farmer must develop some expectations about the economic and political climate in which he is going to operate. No one knows for sure what the climate will be but we do want the expectations that we use in decision-making to be as right as possible. Over the next five years or so we think the odds favor the conditions outlined.

When one attempts to put today's economic conditions known as "stagflation" into a longer run prospective, you will quickly find there are no precedents for today's clash of forces. Never have we had a raid on the world's industrial nation's treasures such as the Organization of Petroleum Exporting Countries (OPEC) quadrupled oil prices. Not in modern history such a global food and feed grain shortfall. Never such worldwide economic interdependence. Never such high levels of commodity prices. Never such an arsenal of recession fighting weapons like income transfer payments, unemployment compensation, federal deposit insurance and Federal Reserve Board actions. Never such an unprecedented movement to goals such as environmental and consumer protection.

Price Levels

From this setting a number of questions arise. Are we headed for a big fall from high levels? Have we broken the long time cyclical conditions and will we continue upward? Are we experiencing a cooling off period with a few years of calm and prosperity?

No one knows how long the current recession will last. Optimists believe it will be over later this year; pessimists think it will last for many months and; a few think it will develop into a kind of 1930 depression.

My assessment is that we will pull out of the recession in the next year. The hopeful signs outweigh the bearish. Signs are emerging that the OPEC countries are experiencing some weakness in their monopoly structure. This could mean softening of oil prices relieving some of the stress of Japan and

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Europe and their foreign exchange situation. At home, the inflation rate has receded, the stock market has turned upward, inventories are being lowered, labor productivity is improving, savings have improved, interest rates have moderated and surveys indicate consumer confidence is slowly returning. Generally, these conditions lead a recovery in economic activity by 6-18 months.

My belief is strongly reinforced by the idea that political realities outweigh economics. In our system (and other free industrialized countries) a higher priority is given to the goal of maintaining a high level of employment than to fighting inflation and maintaining a relatively stable money value. Witness the rapidity with which we shifted from fighting inflation to curing recession in late 1974. Specific examples include the income tax rebate, lowering income tax rates, extending unemployment compensation, increases in social security payments and federal reserve policies to increase the money supply.

Our expectations are that we will pull out of the recession in the next year followed by a short period of moderate price increases. I fear that the political system will maintain expansionary policies too long. Then we may experience a renewal of inflationary price increases unless we have expanded plant capacity and/or improve industrial labor productivity. I am pessimistic on both.

Some portion of inflation is due to demands for environment and consumer protection which results in a product bearing the additional costs of improved environmental quality and safety.

Over long periods of time, farm costs and prices fluctuate with the general level of prices. Thus it appears the general level of farm costs and prices would head upward.

Trade and Trade Policy

U. S. grain farmers have become increasingly dependent on world markets with dynamic, fluctuating prices. Big price variations since 1972 can be attributed to: a) bad weather and lower output in highly populated, vulnerable areas of the world, b) low inventories available for worldwide distribution as the major grain exporters-- U.S., Canada, and Australia--idled land in the late 1960's and early 1970's, c) unexpected and relatively large commercial exports to the U.S.S.R. and Peoples Republic of China, d) rapid growth in demand by wealthy grain importing countries for livestock feeding, e) devaluation of the dollar that expanded commercial sales, f) worldwide price inflation and shortages of inputs like fertilizer and fuels, and g) export restrictions by the U.S. government and import constraints by various nations.

We expect the volume of both U.S. exports and imports of farm products to trend upward in the next five years. Export volume will be erratic due to year to year variations in weather and purchase patterns of the Communist Bloc countries. Also, we assume poor weather and fishing are not permanent and the production responses around the world from higher commodity prices and governmental policies will bring forth greater output in both importing and exporting countries. This will result in short run stress on farm prices and incomes

In the longer run, world population growth in the less developed nations plus income improvement in the developed nations augers well for U.S. exports. Also, U.S. farmers have the comparative advantage in producing soybeans and feed grains. The domestic energy and balance of payments situation will favor policies and programs encouraging the export of large quantities of U.S. farm products. Even so, the U.S. tends to be a residual supplier of wheat and, possibly, feed grains. This subjects U.S. grain farmers to greater variation in demand and prices and livestock producers to highly variable input costs under today's freer market.

The belief that the volume of farm products exported will expand (but irregularly) in the longer run assumes that commercial trade will be encouraged as 1) the most favored nation treatment is extended to the U.S.S.R., and 2) nationalism and self-sufficiency which is growing in the U.S. and around the world will be thwarted by recognition that trade contributes to higher levels of living.

Issues in regard to how much food aid will go to the needy in less developed countries will be in the forefront. The food needs of less developed countries by 1985 with diets holding steady, will require three times the volume ever experienced. The real outcome may be a blend but the polar outcomes are 1) economic growth to buy enough food to maintain diets, 2) food aid transfers or financial transfers by developed countries, or 3) dietary erosion, malnutrition and starvation. Expansion in food aid will depend upon the willingness of U.S. taxpayers to increase their public or private giving.

Imports of farm products will continue to grow for both competitive and noncompetitive products, but our farm trade balance will remain favorable. However, the U.S. may be faced with two pressures to increase farm imports. One is from the less developed countries to give them preferential treatment so they might earn more foreign exchange. The second is that the U.S. will be under continuing pressure to reduce our restrictions on the imports of beef, milk and cheese. GATT negotiations are underway. U.S. interests are to reduce EEC and other countries trade barriers to U.S. products. The agricultural interests of the EEC are protectionistic and favor world commodity agreements. Third world countries view commodity agreements favorably.

Government Programs

Governmental policies related to agriculture have made a dramatic shift. We have moved from a farm program restricting farm output to a more market oriented system featuring food demand policies. This general trend seems likely to continue in the foreseeable future. Feeding the poor through supplemental means like food stamps, school milk, school breakfast, feed the elderly programs, etc. have gained in importance. Subsidizing food consumption of the middle and upper income families through the school lunch program recently received ready approval by Congress. These demand expansion programs now take over 60 percent of the USDA budget and the annual costs exceed the payments made to producers in the early 1970's for retiring land.

Farm programs in the foreseeable future seem likely to feature the target-support price system with voluntary land retirement options. Congress will be sensitive to the welfare of farmers and their incomes even though the Farm Bloc has lost influence due to reapportionment. If farm prices decline, as many expect this fall, price supports might be raised. Also, many farmers and some of the farm organizations will favor a food reserve system. They may be joined by certain business interests, consumer groups and those concerned with feeding poor people in other lands in rationalizing a strategic food reserve program. Any new food reserve program will have to surmount many problems like who stores, what level, who pays, who disposes and who gets.

Productivity

Productivity in U.S. agriculture continues to increase at a higher rate than the economy as a whole. However, grain yields per acre are leveling off. Farm output per unit of input is increasing at a slower rate than a decade or two ago Major reasons for the slowdown in output per unit of input comes about because 1) the best technologies have been used, 2) ecological restraints have reduced efficiencies and increased costs, 3) rising energy and fertilizer costs mean more economic allocation, and 4) expanding use of marginal land. Today's continued expansion of total output is coming about partially through higher yields. But we are using more resources today, especially fertilizer, machinery and land. We are far from completing the automation and adoption of new technologies to farming, even though we are in a cost-price squeeze.

Farm Inputs

In recent years the huge increases in land prices resulted from 1) a big bulge in net farm income, 2) security demand for land and 3) more favorable financing by the Federal Land Bank being added to the normal demands for 4) farm enlargement, and 5) nonfarm uses. In the next few years we may experience some decline in land prices as net farm incomes are squeezed. But over the long haul, land prices and land rents will rise but at a much lower rate than in the recent past. Hired farm labor costs will rise faster than nonfarm wages. This is because farm workers will receive more fringe benefits and farm wage rates will approach nonfarm rates. This encourages mechanization as we are far from completing consolidation and automation into the most economic sized units.

Economic Organization

Increased coordination of agricultural production and marketing by the food processing and farm supply industries can be expected. Our affluent society wants a steadier flow, higher quality and more standardized supply of food The outside pressure will result in an increase in contracting and other marketing and bargaining arrangements. Some of the pressure will occur from the farmer, some from farm supply firms upward, and some from the processor-distributor downward. Some marketing efficiencies can be gained but at the loss of decision-making freedom. With these conflicts a wide variety of marketing arrangements and market organizations may develop depending largely upon the enterprise.

Summary of General Expectations

The political and economic climate outlined will likely result in a narrowing of profit margins below those experienced the last three years. In the 1972-74 period most every enterprise important in the four state region experienced "best of times." However, some experienced more of the "worst of times."

MEANING TO PRODUCERS

The changes in our economy will "push and pull" farmers in diverse directions in the next five years. Narrower margins and greater price uncertainty will test the capabilities of many operators. In the final analysis, the individual farmers decisions and his actions bring about success or failure. Following are some major factors that individual producers might want to consider.

Farms and Farm Size

Two-fifths or one million farmers selling over $20,000 per year account for 95 percent of all U.S. farm products sold. About 16% or 446,000 are the larger commercial farmers that annually sell over $40,000 or 70 percent of the total farm sales. These larger commercial farms will continue to increase in number and receive a larger share of the total value of farm production as they continue to gain control of additional resources. They will benefit from either price and income benefits or their neighbor's financial stress in the next 5 years.

Three-fifths of all farms have total sales of under $20,000 and produce only 5 percent of all farm products. A large portion are part-time farmers with total family incomes that compare favorably with non-farm people. Many farm as a hobby and as a group have a lot of "staying power." Those that are subsistence farmers are the social problem segment and welfare programs will be of increasing importance in providing them assistance.

Farmers selling $20,000 to $39,999 of farm products annually make up about one-fourth of the total number of farms and one-fourth of all sales. Many are older and will forego expansion but will need to modernize their operations and practices. The younger people will either expand the scope of their operation and move into the larger commercial class or will quit farming or join the ranks of the part-time farmers and shift to more extensive operations.

Farm Tenure

Full owner operators now make up nearly 65 percent of the total. Part owner-operator status is growing and now accounts for over 25 percent of the total farm operations -- up from 15% in 1950. Full tenancy is declining and makes up about 10 percent of the total farming operations. These trends are expected to continue.

Economic Units

The larger commercial operations will move toward two or three man units This provides the opportunity for labor specialization and for the amenities enjoyed by non-farm people like vacations, shorter work week, etc. Producers expanding, need to figure on the production per man of 500-600 acres of crops. In the livestock enterprises, including feed production, output per man needs to reach 800-1000 head of hogs marketed per year; about 50-60 dairy cows; 250-300 beef cows, and; in cattle feeding 400-500 steers marketed. For poultry enterprises with feed purchased, a per man egg laying operation needs to be 40,000-50,000 hens per man; an outdoor turkey operation should number 40,000-50,000 per man per year and; 250,000 broilers.

Investment

Investment in agriculture in 1974 reached \$477.5 bil. (current dollars). The annual increase in the last decade was 10% but heavily influenced by the 46% increase from 1971 through 1974. The debt to asset ratio has varied between 16 to 20% in the last decade and may remain so in the years ahead. Of the total annual cash flow for purchase of real estate, capital improvements and production assets about 2/3 has been generated by income and savings. The remainder by secured real estate or tangible property. Land contract sales will expand as sellers look at income tax and buyers look at pressures to acquire more land. Farm indebtedness will rise with the general price level.

On a constant 1967 dollar basis, total assets increased \$11.1 bil. in the last decade. Land values increased \$2.6 bil. and investments in cooperatives savings bonds, certificates and other deposits declined \$2.8 bil. and more than offset the increase in real estate assets (constant dollars). The non-real estate assets of livestock, machinery, vehicles, crops stored and household equipment increased \$11.3 bil. in the last decade. This was at an annual rate of 1.8 percent per year as producers substituted machinery for labor and expanded livestock operations. Investment credit policies had to be a factor.

Output Growth

Output per worker in farming has increased at an annual rate of about 6.5% in the last decade. To keep pace with this competition, the average farmer will need to increase his volume at an annual rate of 6.5 percent. To catch up, the younger and/or smaller commercial farmer needs to think of annual increases exceeding 10 percent. Some of the increase can come from improving yields but the remainder must come from more intensive operations or farm enlargement.

Livestock Production

Livestock operations will continue to move to full owner or part-owner operated farms. Gains from mechanization tend to come from a larger volume rather than from lower unit costs. Narrower margins reduce the degree of error permissable and requires higher levels of management. When negative returns are experienced there is nothing worse than being "big and bad." Landlords will be increasingly reluctant to make large investments in economic sized livestock units; tenants will be reluctant to use outmoded facilities.

Marketing Practices

Producers facing lower margins, higher financial burdens and greater uncertainties will need to minimize risks. Creditors will increasingly require borrowers to "lock in profits." Thus, hedging, forward contracting, interval selling, or selling before planting or at time of placement in feedlots will expand.

Management Practices

Financial management, record keeping, tax management, estate planning and business organization practices will be of increasing importance. The large investment (equity or borrowed) per farm, narrower margins, increased market coordination and quality control will necessitate such changes. The source and quality of production and marketing information made available by the land grant institutions, farm supply firms and marketing organizations and the interpretation of such information will be of increasing importance.

SUMMARY

On the average the earnings of commercial farmers in the next five years may not reach the 1970-74 earnings but may exceed the decade of the 1960's. This means a relatively good climate for those operators who have control of adequate resources, who market wisely and have good management. Those farmers, whether smaller or for other reasons, unable to make adjustments will be under severe pressure. The casualty rate of those financially overextend or lacking management capabilities will be high.